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Supreme Court, U.S.
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No. 85-2036

In The
Supreme Court of the United States
October Term, 1985

UNION ELECTRIC COMPANY,

Petitioner,

vs.

HAROLD HARRIS, CONTINENTAL CASUALTY COMPANY, a corporation, and NATIONAL FIRE INSURANCE COMPANY OF HARTFORD, a corporation, individually and as representatives of all of the holders of the $70,000,000 first mortgage bonds of Union Electric Company, 10½% Series due March 1, 2005, as of April 11, 1978,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

I. Whether the Eighth Circuit's holding that the prospectus failed to disclose material facts concerning the exceptions to the "no-call" feature of the bond contract was correct and based upon sound principles of construction and creates any conflict with other circuits or prior decisions of this court on important issues of federal securities law?

A. Whether the Eighth Circuit's holding that the prospectus failed to disclose material facts concerning the exceptions to the "no-call" feature of the bond contract was correct and based upon sound principles of construction?

B. Whether the Eighth Circuit's decision is in conflict with the decision of the Fifth Circuit in Broad v. Rockwell International Corp., with that of the Second Circuit in Fershtman v. Schectman, or with its own decision in St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.?

II. Whether the Eighth Circuit's holding properly employed an out-of-pocket measure of damages and is in conflict with the weight of authority or with § 28(a) of the Securities Exchange Act of 1934?

III. Whether the Eighth Circuit's holding that the class purchased "in connection with" the fraudulent conduct of Union Electric is in conflict with Blue Chip Stamps v. Manor Drug Stores because the plaintiffs' bringing this action and the class members were found to have been purchasers and because the purchasers were causally connected to the fraudulent conduct?

IV. Whether the Eighth Circuit exceeded the appropriate scope of judicial review and relied on a theory not submitted to the jury in affirming the District Court's decision to exclude evidence which was irrelevant and immaterial to the issue of Plaintiffs' damages?

A. Whether the Appellate Court exceeded the appropriate scope of appellate review?

B. Whether the evidence excluded by application of the "second investment decision" rule was irrelevant and immaterial to the issue of Plaintiffs' damages?

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OPINION BELOW

The opinion of the court of appeals is reported at 787 F.2d 355, and is reproduced as Appendix A to Petitioner's Petition for Writ of Certiorari. References to the court of appeals opinion will be cited as "Op.", with reference to the page number in Appendix A to the Petition.

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STATEMENT

Respondents object to the purported statements of fact, appearing at pages 3-7 of the Petition and as Appendix P, as being woefully incomplete and so selective as to be misleading. For example, Petitioner states that "in the state court action, the Missouri Court of Appeals, Eastern District, held the petitioner had the contractural right to redeem and to refund the bonds in the manner it had proposed" [Pet p.4], and that "the prospectus describes the bond contract including the "no call" limitation, the Improvement Fund and the Maintenance Fund." [Pet. p.6]

What the Missouri court actually held was that Union Electric could use Maintenance Fund cash to redeem bonds under Article VIII, § 8 of the original indenture. [A-52-3, 56-7] The Missouri court specifically declined to rule on any issue of prospectus disclosure [A-42], and noted that "the Prospectus and disclosure issues are not properly before us." [A-58, n.7]

No mention of this Article VIII, § 8 redemption right, which is what Union Electric attempted in April, 1978, appears anywhere in the prospectus. [A-12]

Respondents would refer the Court to the court of appeals opinion for an accurate and complete rendition of the facts pertinent to the issues of the case.

REASONS FOR DENYING THE WRIT

The Petitioner raises six different arguments under four separate points in its Petition for Certiorari, which are fraught with contortions and mischaracterizations of the Eighth Circuit's Opinion and of the authorities the Petitioner cites in support of its position on the issues discussed. The text of the Petitioner's "Reasons for Granting the Writ" comes dangerously close to an attempt to "hoodwink" this Court. Each one of Petitioner's arguments and contentions is completely without merit and fails to demonstrate any cogent reason why this Court should review the judgment and Opinion of the Eighth Circuit in this case. Respondent's arguments are arranged and numbered so as to correspond with the arrangement and numbering of the points in Petitioner's Petition for Writ of Certiorari.

I.

THE WRIT SHOULD BE DENIED BECAUSE THE EIGHTH CIRCUIT'S HOLDING THAT THE PROSPECTUS FAILED TO DISCLOSE MATERIAL FACTS CONCERNING THE EXCEPTIONS TO THE "NO-CALL" FEATURE OF THE BOND CONTRACT WAS CORRECT AND BASED UPON SOUND PRINCIPLES OF CONSTRUCTION AND CREATES NO CONFLICT WITH OTHER CIRCUITS OR THE DECISIONS OF THIS COURT ON IMPORTANT ISSUES OF FEDERAL SECURITIES LAWS.

A. THE EIGHTH CIRCUIT'S HOLDING THAT THE PROSPECTUS FAILED TO DISCLOSE MATERIAL FACTS CONCERNING THE EXCEPTIONS TO THE "NO-CALL" FEATURE OF THE BOND CONTRACT WAS CORRECT AND BASED UPON SOUND PRINCIPLES OF CONSTRUCTION.

The Petitioner argues that the prospectus disclosed the exceptions to the "no-call" features of the bond contract and attacks the Eighth Circuit's conclusion to the contrary by, among other things, the presentation of a slightly "altered" version of that Court's reasoning. The Petitioner states that "[t]he Opinion (at p. A-11) concludes that **both** interpretations of the cover page are plausible . . . ." [Pet. p.10] The statement is lifted from a discussion of the opposing grammatical construction advanced by the parties concerning the interpretation of the "call protection provision on the cover page of the prospectus." [Op. A-10] The statement referred to was in fact a reference to the ambiguous and misleading nature of the prospectus [Op. A-11,12]; viz.:

> Although the plaintiffs' and U.E.'s interpretations of the cover page provision are plausible, we do not limit

> our determination to this single provision. To the contrary, we consider the prospectus **in its entirety,** as we assume the jury did, **together with** the intention of the parties. When the cover page provision is read together with the redemption provisions on pages three and twenty-eight, and with the Improvement and Maintenance Fund provisions on page twenty-nine, it is clear that the jury could have reasonably found that the prospectus is ambiguous and misleading in that it omits material facts concerning the call protection.

Petitioner contends that the Court's conclusion "cannot be supported by the language of the prospectus"; that its finding of ambiguity "relied upon testimony relating to the intentions of the parties in 1975"; and that "the bondholders were . . . advised of the features of the bond contract in the prospectus." [Pet. p.10] The Opinion succinctly sets forth the gravamen of its conclusion that the prospectus is misleading [Op. A-12], and exposes the vacuity of Petitioner's position here:

> Article VIII, section 8 of the bond contract has been judicially construed by the Missouri Court of Appeals to authorize lower cost refunding at the special redemption prices. Harris v. Union Electric Co., 622 S.W.2d at 251. **The prospectus, however, does not mention Article VIII, section 8.** The prospectus is misleading in that it does not adequately disclose the authorization set forth in section 8, while giving the impression that refunding the bonds at a lower rate of interest before March 1, 1985 is prohibited. The redemption provision on page twenty-eight of the prospectus prohibits lower cost refunding at the Regular Redemption Prices, and the bond contract allows such refunding at the Special Redemption price. **This "protection" is a sham.** The Regular Redemption Prices are premiums, but the Special Redemption Price is fixed at par. **A restriction on lower cost refunding at a premium with no such restriction at par affords**

> **no meaningful protection against call.** UE would never call the bonds at a premium if it could call them at the lower price of par. **This renders the premium price list on page twenty-eight of the prospectus meaningless and misleading,** since it represents prices that would never be paid. Finally, **the prospectus is misleading in that it failed to disclose UE's right to directly call the bonds through the Maintenance Fund.** The bond contract, however, has been judicially construed to provide UE with such a right. Yet, the Maintenance Fund provision on page twenty-nine of the prospectus indicates that funds deposited in the Maintenance Fund may be used indirectly to redeem bonds by first transferring the money to the Improvement Fund. This distinction is important because had UE redeemed the bonds indirectly through the Maintenance Fund according to the provisions on page twenty-nine, it could not have avoided paying the premium prices. The jury reasonably could have found that the prospectus is misleading and ambiguous in that it omits material facts that would have adequately disclosed the call protection of the bonds. (Emphasis supplied).

Petitioner relies heavily on *Lucas v. Florida Power and Light Co.*, 765 F.2d 1039 (11th Cir. 1985), and states that "the testimony at trial of the instant case was that Union Electric officials were not aware of the possibility of a maintenance fund redemption until after the Florida Power & Light Company redeemed its bonds." [Pet. p.10] Not only is this statement not true, but the factual issues on this point were resolved by the jury against Petitioner. As noted by the Court in its opinion [Op. A-13, n.7]:

> . . . The evidence is inconsistent concerning this point. Although UE contends that none of its officials were aware of the possibility of calling the bonds in the manner in which it planned, Mr. Friel, a vice president and the controller at UE, testified that he was aware of such possibility in 1975. Even if UE officials did

not deliberately leave the meaning of the prospectus obscure, they were obviously aware of uncertainties, the meaning of which were decided at a later date to suit UE's purposes.

The Petitioner's discussion of *Lucas v. Florida Power and Light Co.*, supra, does nothing to refute the Eighth Circuit's decision in the instant case. Whether the language in the Florida Power & Light prospectus was "boilerplate" or not has no bearing on that case's applicability to *Lucas'* at bar. In *Lucas*, the prospectus specifically referred to Florida Power's ability to redeem the bonds in the fashion it did, language which is notably absent in the Union Electric prospectus. *Id.*, at 1041; *c.f.*, Pet. pp.A-59-70. In addition, that case involved a **redemption**, whereas the present case involves a **refunding**. [Op. A-23] Nowhere in *Lucas* does the Eleventh Circuit hold that the call protection provision in that prospectus disclose the possibility of an early **refund**. The Eighth Circuit's distinction of *Lucas* on its facts clearly makes the ultimate holding in that case inapplicable here. If *Lucas* is taken to stand for the proposition that the Court must look to the language of the prospectus to determine whether the prospectus was misleading it still does not conflict with what the Eighth Circuit did in this case. Here, having examined the prospectus and having found the ambiguities noted above, the Eighth Circuit referred to testimony concerning the intent of the parties, only to find that the prospectus should be resolved as representing the bonds in question as having solid protection against lower interest cost refunding for ten years. [Op. A-14-15] Such ambiguities were not present in *Lucas*.

Petitioner's reliance on *Associated Builders, Inc. v. Alabama Power Co.*, 505 F.2d 97 (5th Cir. 1974), also is of

no help to its position. In that case, the Court found the prospectus to be not misleading based upon a finding that although a material fact was not disclosed on the cover page of the prospectus, it was disclosed elsewhere in the prospectus. In the instant case, the Court took pains to make it clear that its findings that the prospectus was ambiguous and misleading were based upon a reading of the prospectus as a whole, not just of the cover page. [Op. A-11-12] Despite the Petitioner's contention that "the disclosures appear at three places including the cover page of the prospectus" [Pet. p.13], there is no disclosure of the Article VIII, § 8 redemption right, which is what is involved in this case, that appears anywhere at all in the prospectus. [Op. A-12]

Petitioner also attempts to manufacture a conflict between the Eighth Circuit's decision and that of the Fifth Circuit in *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir. 1981) (en banc) *cert. denied*, 454 U.S. 965 (1981), apparently arguing that Union Electric was under no "duty to disclose **in a detailed fashion** the indenture's provisions for more remote future contingencies". [Pet. p.14] (Emphasis added). The point is irrelevant since not only were the exceptions in Article VIII, § 8 of the Union Electric bond contract not disclosed in a detailed fashion, they were not disclosed at all. The prospectus does not even mention that Article VIII, Section 8 exists. [Op. A-12] In addition, the prospectus goes on to give the impression that the refund procedure allowed by the section is in fact prohibited. *Id.* In addition, the *Broad* opinion is inapplicable for the simple reason that the very creation of the undisclosed contract right in that case occurred **after** the alleged fraud was

committed, where here the fraud involved not only the failure to disclose the Article VIII, § 8 redemption right, but also the use of that right by UE after duping the bondholders into a false sense of security that no such right existed.

The Petitioner's reliance on *Franklin Life Insurance Co. v. Commonwealth Edison Co.*, 451 F. Supp. 602 (S.D. Ill. 1978), *aff'd*, 598 F.2d 1109 (7th Cir.), *cert. denied*, 444 U.S. 900 (1979), is also misplaced. In that case, the Court found a failure to establish "that defendant omitted a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading because the material facts omitted were not objective, but were rather subjective, involving defendant's intent and beliefs concerning **interpretation** of the redemption provision". *Id.*, at 608-609; Pet. p.14. This is not the situation present in the instant case. The Eighth Circuit went to great lengths to point out specifically how the prospectus as a whole was misleading and which misrepresentations and omissions rendered it so. [Op. A-12] The facts omitted here were not subjective at all. The Plaintiffs-Respondents have never contended that the prospectus was misleading for failure to disclose the intents or beliefs of the Defendant-Petitioner, and the Circuit Court did not base its holdings on any such contention or finding. The Eighth Circuit's description of the fraud [Op. A-15] makes it clear that neither *Lucas* nor *Broad* have any relevance to this case, nor do those decisions conflict in any way with that in this case:

> Based on the language of the prospectus, the testimony of the parties expressing their intentions, and the testimony of the market experts, we conclude

that the plaintiffs produced sufficient evidence for the jury to have found that the prospectus is ambiguous and misleading in that it omitted material facts that would have adequately disclosed U.E.'s right to call the bonds, in violation of Rule 10b-5(b). We also conclude that the evidence is sufficient for the jury to have found that these omissions were part of a larger scheme or course of business to defraud the bondholders. **To knowingly implement a plan in 1978 to call bonds that were previously intended and marketed as having solid call protection until 1985, constitutes a course of business, or a device, scheme, or artifice that operates as a fraud on the bondholders in violation of Rule 10b-5(a) and (c).** Therefore, UE's conduct falls within all three subparagraphs of Rule 10b-5. (Emphasis supplied).

Petitioner's Point I, A is without merit.

B. THE EIGHTH CIRCUIT'S DECISION DID NOT HOLD PETITIONER LIABLE UNDER RULE 10b-5 FOR EXERCISING A CONTRACTUAL RIGHT, BUT FOR ENGAGING IN A SCHEME AND COURSE OF BUSINESS TO DEFRAUD, AND IS NOT IN CONFLICT WITH THE DECISION OF THE FIFTH CIRCUIT IN BROAD v. ROCKWELL INTERNATIONAL CORP., WITH THAT OF THE SECOND CIRCUIT IN FERSHTMAN v. SCHECTMAN, OR WITH ITS OWN DECISION IN ST. LOUIS UNION TRUST CO. v. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

Petitioner attempts to characterize the Eighth Circuit's decision as imposing 10b-5 liability for the mere exercise of a contractual right. It attempts to castigate the Court for its finding of scienter, and follows with a selective presentation of what it denominates as the reasoning of the Court's opinion. In fact, Petitioner's pre-

sentation is nothing more than a thinly disguised attempt to obfuscate the real issues of the case and mislead this Court as to the factual situation which constitutes the fraud.

Petitioner begins by attempting to show that the Court based its finding of scienter on the existence of reckless conduct alone [Pet. p.16]:

> It was UE's intent that the bonds would possess solid protection against call for 10 years. To represent and market the bonds as possessing such protection and then implement a plan to call the bonds within the 10 year period, constitutes at the very least recklessness on UE's part. [Op. A-22, n. 12]

However, the Court's finding of scienter was not based on recklessness at all, but rather on intentional conduct, as a reading of the opinion clearly shows [Op. A-21]:

> . . . There is substantial evidence demonstrating the UE knew that the plan was contrary to its representation in the prospectus concerning the call protection. Several UE officials testified that the company, without a doubt, initially intended to provide "solid protection" against call for ten years. The evidence indicated that Mr. Grainger, one of UE's Advisory Directors, vehemently opposed the plan as "subordinating moral responsibility for financial gain," and cautioned UE's president that the "contract with the Bondholders should be kept inviolate." UE's Vice President of Finance, Mr. Welshans, testified that the company was well aware that the plan was contrary to the protection that the underwriters, the bondholders, and Union Electric all mutually intended the bonds to possess. The evidence also indicated that UE only hesitated long enough to assure itself that it could re-enter the bond market at a later date without any trouble. Once UE observed that

> FP & L's plan did not adversely affect its ability to re-enter the market, UE implemented its plan. . . . Clearly, the evidence is sufficient from which the jury could have found that UE acted with the intent to defraud the bondholders.

Petitioner's major argument is basically that it could not have violated Rule 10b-5 because it was only attempting to exercise a contract right, and that the Eighth Circuit's opinion thus conflicts with *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir. 1981); *St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 562 F.2d 1040 (8th Cir. 1977); and *Fershtman v. Schectman*, 450 F.2d 1357 (2d Cir. 1971). However, the facts show that Petitioner's conduct cannot honestly be characterized in so innocent a fashion.

Union Electric, the bondholders and the underwriters intended the bonds to have a solid protection against call for 10 years. [Op. A-13, n. 7; 14; 15; 21; 22, n. 12; 23; 24] Union Electric, through the prospectus, represented to the public that the bonds would indeed possess that protection, [Op. A-11-15] Union Electric marketed the bonds based upon the existence of the solid call protection. [Op. A-15, n. 8] Plaintiffs purchased the bonds in reliance upon that representation. [Op. A-17] Union Electric later implemented a plan which it knew was contrary to the representations made in the prospectus. [Op. A-21] It was the implementation of that plan which rendered the representation in the prospectus concerning solid call protection false and misleading. [Op. A-19] Hence, Union Electric "certainly intended to defraud the bondholders of this protection when they announced the plan to call the bonds before the ten-year period had run". [Op. A-21]

To paraphrase—All the parties intended the bonds to have solid protection against call for ten years, and indeed the securities were bought and sold with all parties believing that such protection existed. So far as everyone involved was concerned, the protection described in the prospectus was real, and indeed was inflating the price of the bonds as it had from the time the initial issue was offered and sold. Then, three years later, Union Electric in effect announces: "We know the bonds were supposed to have solid call protection for ten years; we know we are the ones who said that they would and we know that you only paid the price you did at the yield offered because of that protection; we know that we have taken full advantage of your belief that these bonds were non-refundable for 10 years; but we have just discovered a way to call the bonds early that we didn't know about before, and although we know that it is inconsistent with what all of us intended the bond contract to be, we're going to do it despite our representation to the contrary in the prospectus and regardless of the effect upon your investment."

As the Circuit Court pointed out, *Broad* and *St. Louis Union Trust Co.* are readily distinguishable from the instant case in that "[u]nlike the situations in *Broad* and *St. Louis Union Trust Co.*, the parties' intentions in this case were contrary to the subsequently construed contractual right in question. It's undisputed that U.E. marketed the bonds as possessing solid call protection for ten years." [Op. A-15, n. 8] The Eighth Circuit recognized, and the Petitioner ignores, the fact that the Article VIII, § 8 right that Union Electric attempted to exercise was not disclosed and was a material fact. Neither case sup-

ports the Petitioner's position, nor holds that an issuer can omit disclosures of material provisions of the terms of a bond, and then later exercise such rights to the detriment of the bondholders. These two cases can further be distinguished by the fact that in both *Broad* and *St. Louis Union Trust Co.*, the rights in question were created by contracts which were independent of the security in question. Here, the refunding right under Article VIII, § 8 springs from the bond contract itself, which created the security in question. Union Electric's reliance on *Broad* and *St. Louis Union Trust Co.* is obviously misplaced.

Petitioner also argues that the Eighth Circuit's decision is in conflict with *Fershtman v. Schectman,* 450 F.2d 1357 (2d Cir. 1971). In that case, there was a discrepancy between provisions in a limited partnership agreement and in the certificate of limited partnership. The general partners brought about termination of the partnership in accordance with the provision in the limited partnership agreement. Plaintiffs' claims under Rule 10b-5 were dismissed because of lack of federal jurisdiction and failure to state a claim under Rule 10b-5. The reasons given by the Court were many. None of the alleged misrepresentations and omissions, save one, were material nor did they cause damage. *Id.*, at 1360. The one misrepresentation which may have been material was made negligently and did not cause damage. *Id.*, at 1361. Furthermore, the partnership agreement and the certificate of limited partnership were both sent to and received by the plaintiffs. The only misrepresentation which might have been considered to be material was in the form of

an attorney's opinion letter concerning the discrepancy between two documents. The letter was written after the partners had already signed the agreement and may never have come to the plaintiffs' attention at all. *Id.*, at 1360-1361. The most important factual distinction between the *Fershtman* case and the case at bar is that the document which purportedly gave rise to the right exercised (the partnership agreement), was disclosed to the plaintiffs in that case, whereas in the instant case, there was no disclosure of the Article VIII, § 8 right. The circumstances in *Fershtman* are so different from those in the present case that not even the incomplete statements quoted by the Petitioner from that opinion can apply here.

The Court's holding that Union Electric's conduct in representing and marketing the Series 2005 bonds as having solid call protection for 10 years, and then announcing their intention to implement a plan to call those bonds before the ten-year period had expired with intent to defraud the bondholders, constitutes a course of business, or a device, scheme, or artifice that operates as a fraud on the bondholders in violation of Rule 10b-5(a) and (c), [Op. A-14-15; 22, n. 12], is correct and does not conflict with the holdings of the Fifth or Second Circuits, nor the prior decisions of the Eighth Circuit. The Petitioner's Point I, B is also without merit.

II.

THE EIGHTH CIRCUIT'S HOLDING EMPLOYED AN OUT-OF-POCKET MEASURE OF DAMAGES AND IS NEITHER IN CONFLICT WITH THE WEIGHT OF AUTHORITY NOR WITH SECTION 28(a) OF THE SECURITIES EXCHANGE ACT OF 1934.

Petitioner contends that the Eighth Circuit held that the announcement to call the bonds caused the plaintiffs' damages [Pet. p.19]; that the Plaintiffs were allowed to recover for a temporary market drop and paper loss [Pet. p.20]; and that "the plaintiffs and the class did not sustain any actual damages." [Pet. p.19] None of these statements are true.

Petitioner admits that the proper measure of damages is the "out-of-pocket loss, namely, the excess of what [they] paid over what [they] got". [Pet. p.19] The Court's Opinion makes it abundantly clear that this is precisely the measure of damages used in this case [Op. A-18-19]:

> The proper measure of damages in this case is the difference between purchase price and the actual value of the bonds on the date they were issued. This remedy is best suited to the harm in this case because it represents the reduction in the value of the bonds caused by the lack of call protection. Although the plaintiffs purchased the bonds for less than 101, the bonds were worth much less because the call protection that the plaintiffs thought they were purchasing did not exist. The plaintiffs paid more for the bonds than they were actually worth.

There is no need at this point to reiterate the Eighth Circuit's discussion of authority for choosing the measure it did, [Op. A-17-19], as the Petitioner's argument, mis-

construing the Circuit Court's holding as it does, fails to challenge it.

The Opinion cites "ample evidence" introduced by the Plaintiffs-Respondents to show that, in order for Union Electric to sell the bonds without the call protection at the 10½% interest rate, it would have had to do so at a substantially lower price. The damages then were measured by the "reduction in the initial purchase price of the bonds that would have been necessary in order to sell them at 10½% without the call protection". [Op. A-19] Logically, that price value differential not only existed at the time the bonds were issued, but continued to exist until the absence of the call protection became known and the market adjusted the price of the bonds to reflect the absence of the call protection. Plaintiffs submitted substantial evidence of what this differential was, of which the market drop was but one factor. The Circuit Court agreed that the reduction in the market value of the bonds on the date the fraud was discovered evidence was that "fairly represents the reduction in the initial purchase price of the bonds that would have been necessary in order to sell them at 10½% without the call protection." [Op. A-19] The "market drop" then was not the measure of damages at all, but rather it represented evidence which was used to help measure "the difference between the purchase price of the bonds and their true value on the date purchased" as being $120. [Op. A-19] The jury's award of $40 per bond was obviously based on its consideration of other evidence as well, and is living proof that the jury did not consider the market drop to be the measure of damages *per se*, as Petitioner now contends.

The Circuit Court's holding, that damages are to be measured by the difference between the actual value of the bonds and the purchase price on the date of issue and that the "market drop" was evidence properly used to ascertain the amount of that difference because it fairly represented the reduction in price necessary to sell the bonds on the date of issue at 10½% and without the call protection, is a proper one allowing Plaintiffs-Respondents to recover only those "actual damages" allowed under Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a) and under the weight of judicial authority interpreting that section. Petitioner's Point II is without merit and must fail.

III.

THE EIGHTH CIRCUIT'S HOLDING THAT THE CLASS PURCHASED "IN CONNECTION WITH" THE FRAUDULENT CONDUCT OF UNION ELECTRIC IS NOT IN CONFLICT WITH BLUE CHIP STAMPS v. MANOR DRUG STORES BECAUSE THE PLAINTIFFS BRINGING THIS ACTION AND THE CLASS MEMBERS WERE FOUND TO HAVE BEEN PURCHASERS AND BECAUSE THE PURCHASERS WERE CASUALLY CONNECTED TO THAT FRAUDULENT CONDUCT.

There is no doubt that a threshold requirement of a Rule 10b-5 action is that the Plaintiffs, in order to maintain a private action for damages under the Rule, must be either purchasers or sellers of a security. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 725 (1975). There really is no legitimate issue as to the standing of the Plaintiffs-Respondents as purchasers of the Series 2005 bonds. The Petitioner is attempting, however, to also

cite the ubiquitous *Blue Chip Stamps* as authority for its contention that **all** members of the class must be shown to have been purchasers. No such contention was made to the trial court, and thus is not properly preserved for review. However, *Blue Chip Stamps*, does not hold that such a showing must be made with respect to each individual member of a class, nor does Petitioner offer any authority to such effect. Petitioner attempts to impose an impossible burden on representatives of large classes which would defeat the very reason for the existence of a class action in the first place.

In fact, despite the definition of the class in the instant case, the Eighth Circuit did find that the class members were "purchasers". The Circuit Court's statement in footnote 11 on page 20 of the Opinion does not, as Petitioner contends, substitute a general "dealing in the security test" for the purchaser or seller requirement. The body of text to which this footnote refers states [Op. A-20]:

> . . . we believe that UE's fraudulent conduct "touches" the class members' **purchases** of their bonds. . . . If the call protection had been accurately disclosed before these members of the class **purchased** their bonds, they would have paid less for the bonds or demanded a higher yield. Clearly, these members of the class **purchased** their bonds in connection with UE's fraudulent conduct." (Emphasis supplied).

It is clear that the Circuit Court found that those class members "dealt in the security to which the omissions concerning the call protection relate" as "purchasers". [Op. A-20, n.11]

Petitioner next attacks the Eighth Circuit's finding that Petitioner's fraudulent conduct "touches" the class

members' purchases because the market price "reflected the misleading call protection" and because these purchasers would have "paid less" or "demanded a higher yield" had the call protection been "accurately disclosed". [Op. A-20; Pet. for Cert. 22]. The Eighth Circuit's finding was based on the holding of this Court in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971), that a showing that the fraudulent conduct "touches" the purchase or sale of securities satisfies the "in connection with" requirement.

The Petitioner begins by stating in footnote 9 on page 22 of its Petition for Certiorari that the Eighth Circuit's finding is factually inaccurate because it was not shown that the class members made their purchases at the time the bonds were issued in 1975. This contention is absurd, especially in light of the Circuit Court's discussion of the issue of reliance [Op. A-16-17] (which, incidentally, is not challenged by the Petitioner), and of the issue of the measure of damages [Op. A-18-19] (which, as discussed in the previous section of this Answer, the Petitioner completely misconstrues). The effect of the misleading omissions and representations in the prospectus, indeed of the entire course of fraudulent conduct, on the market price of the bonds was present not only on the day of issue, but continued until the fraud was discovered in April, 1978. Throughout that entire period the market price of the bonds reflected the belief in the existence of the call protection, so that anyone who purchased the bonds during that time period would have been paying a premium for call protection that didn't exist. Since the class members who purchased after the issue date but before April 11, 1978 relied on the market, affected as it was by the fraud,

in making their decisions to invest in the bonds, the fraud "touched" all of the purchases made within that period. The fact that the class members would have paid less or demanded a higher yield had the call protection been accurately disclosed was as true the day before Union Electric announced its plans to call the bonds as it was on the day the bonds were issued.

The Petitioner also contends that the theory used by the Eighth Circuit relying on *Bankers Life* "ignores the 'in connection with' requirement by substituting a new and unidentified standard". [Pet. p.22] Nothing could be further from the truth. The standard used by the Eighth Circuit in its discussion of this issue is taken directly from this Court's Opinion in *Bankers Life.* Neither the standard itself, nor the use of it, ignores the "in connection with" requirement, but rather are based upon that requirement. Though the requisite "touching" was not defined in *Bankers Life,* the Plaintiffs-Respondents have no doubt that whatever connection this Court had in mind as meeting this test, the "causal connection between the alleged fraud and the purchase or sale" would, no doubt, be involved. Even with this in mind, the "in connection with" requirement was satisfied in this case, as held by the Circuit Court.

The Plaintiffs-Respondents agree that the purchase or sale of securities occurring prior to the fraudulent conduct or after the fraudulent conduct is exposed would probably not be made "in connection with" that fraudulent conduct. Although the Petitioner contends that the Eighth Circuit found that it was the 1978 redemption announcement which constituted the fraud, the Opinion demonstrates otherwise. The Eighth Circuit specifically found that the

Petitioner's entire course of conduct from the representations in the prospectus in 1975, through the announcement to refund the bonds in 1978, constituted a "course of business and scheme or artifice which operated as a fraud on the bondholders". [Op. A-7, 14-15, 21, 24] Accordingly, since the named plaintiffs and class members all purchased their bonds during this period, all of those purchases were made "in connection with" the fraudulent conduct of the Petitioner which also occurred during that same period. The important thing is that the purchases were made during the course of conduct by the Petitioner which was prohibited by Rule 10b-5. That the petitioner may not have decided until later to taint this course of conduct by using it to defraud the bondholders does not sever the connection between the conduct and the purchases it procured.

There was no misapplication or erosion of *Blue Chip Stamps* by the Eighth Circuit in this case. There is no merit to Petitioner's contentions to the contrary in Point III of its Petition for Certiorari.

IV.

THE EIGHTH CIRCUIT DID NOT EXCEED THE APPROPRIATE SCOPE OF JUDICIAL REVIEW BECAUSE THE THEORY RELIED ON BY THE CIRCUIT COURT WAS SUBMITTED TO THE JURY AND DID NOT ERR IN AFFIRMING THE DISTRICT COURT'S DECISION TO EXCLUDE EVIDENCE WHICH WAS IRRELEVANT AND IMMATERIAL TO THE ISSUE OF PLAINTIFFS' DAMAGES.

A. THE APPELLATE COURT DID NOT EXCEED THE APPROPRIATE SCOPE OF APPELLATE REVIEW.

The Petitioner argues that the Eighth Circuit based its decision in this case upon a theory which was neither

pled, proven nor submitted, thereby exceeding the permissible scope of appellate review, and denying Petitioner its 7th Amendment right to trial by jury. Petitioner's contention is inaccurate and therefore must fail. Furthermore, the 7th Amendment argument was never presented to the Court of Appeals, and is not preserved for review.

In paragraph 21 of the First Amended Complaint [A-86-90], and in paragraph 31 of the Amendment to First Amended Complaint [A-112], the Plaintiffs-Respondents did indeed plead a series of allegations that were sufficent to put the Defendant-Petitioner on notice of a claim that the entire course of conduct alleged, [which includes the making of the representations in the 1975 prospectus, the announcement of intent to refund the bonds in 1978, and all the related conduct in between], was in violation of Rule 10b-5. While the pleadings did aver that the material misrepresentations and omissions in the 1975 prospectus and the announcement to call the bonds in 1978 would each, standing alone, constitute violations of various provisions of Rule 10b-5, it also averred that these discreet violations were connected and that they made up a course of conduct which also violated the Rule. That the entire course of conduct by the Petitioner from March, 1975 through April, 1978 constituted a scheme or artifice to defraud and a course of business operating as a fraud against the bondholders was implicit in the allegations found in the First Amended Complaint and the Amendment to First Amended Complaint. In fact, the damage allegations in Count II specifically refer to "the aforesaid devices, schemes, and artifices to defraud, and the aforesaid acts, practices and courses of business which operate as a fraud and deceit upon the Plaintiffs and Class Members." [A-104] It is noteworthy that

Petitioner never attacked the sufficiency of this pleading, nor asked for more definite statement—a tacit admission on its part that it was given fair notice of the Plaintiffs' claims and the grounds on which these claims were based. This is all that is required under the "notice pleading" permitted by the Federal Rules of Civil Procedure. *Conley v. Gibson,* 355 U.S. 41, 47-48 (1957). That the Petitioner may not have recognized the existence of this theory in the First Amended Complaint and the subsequent Amendment thereto can only be attributed to an inability to "see the forest for the trees" and does not change the fact that this theory was contained in the pleadings.

As for Petitioner's claim that this theory of liability was not supported by "any facts in the record", [Pet. p.24], a reading of the voluminous facts cited throughout the Eighth Circuit's Opinion shows that quite the opposite is true. In fact, all of the evidence concerning the Petitioner's conduct during this period supports this theory.

The theory relied upon by the Eighth Circuit was also submitted to the jury in Liability Instruction Number 13 [A-114], which clearly shows that the conduct of Union Electric, as established by the evidence produced at trial, was subjected to the jury's scrutiny under all three provisions of Rule 10b-5. The theory that Petitioner's conduct constituted a "device, scheme, or artifice to defraud" or a "practice or course of business which operated as a fraud or deceit upon any person in connection with the purchase of a security" was not abandoned as the Petitioner claims. In fact, the Eighth Circuit's Opinion points out that not only did the material omissions in the prospectus constitute conduct in violation of Rule 10b-5(b), but also that the entire course of conduct, including the use of the

ambiguous and misleading prospectus, constituted both a course of business and a device, scheme, or artifice which operated as a fraud on the bondholders in violation of Rule 10b-5(a) and (c) so that all three provisions of the rule were violated. [Op. A-14-15] Obviously, the theory of liability relied on by the Circuit Court was submitted to the jury in Liability Instruction Number 13.

Finally, Petitioner argues that the theory relied upon by the Eighth Circuit was not argued on appeal. At their appellate argument, the Plaintiffs-Respondents referred to the conduct of the Petitioner as constituting both "disclosure fraud" and "transaction fraud". This was a shorthand way of referring to the various subparagraphs of Rule 10b-5 violated by the particular discreet instances of conduct involved: "disclosure fraud" referring to that conduct which violates Rule 10b-5(b), while "transaction fraud" refers to that conduct which violates Rule 10b-5(a) and (c). A substantial section of the Plaintiffs-Respondents' brief on appeal, as well as of their oral argument, was devoted to the discussion of how the misrepresentations and omissions in the prospectus, by themselves, constituted "disclosure fraud". However, the Respondents were also careful in their discussion of a "transaction fraud" on pages 26 through 36 of their appellate brief to point out the importance of the representations made in the 1975 prospectus to the overall fraudulent scheme, device, or artifice and course of business employed and engaged in by the Petitioner. Nowhere during the course of this entire appellate process did Petitioner raise the objections that it now presents to this Court. The Eighth Circuit certainly appreciated this interrelationship, argued by the Plaintiffs-Respondents, and the way it served to bind the individual,

discreet instances of conduct by Union Electric into a continuous course of conduct violating the "transaction fraud" provisions of Rule 10b-5, also argued by the Plaintiffs-Respondents, even if the Petitioner did not.

The judgment of the Eighth Circuit was based solely upon facts which were pled, proven, submitted, and resolved by the jury in the District Court below and argued on appeal. Therefore the holding of the Eighth Circuit that Union Electric's entire course of conduct from March of 1975 through April of 1978 as it related to the series 2005 bonds constituted a course of business and a scheme, device, or artifice that operated as a fraud on the bondholders in violation of Rule 10b-5(a) and (c) and was properly within the scope of appellate review. There is no merit to Petitioner's argument in Point IV, A of its Petition for Certiorari.

B. THE EVIDENCE EXCLUDED BY APPLICATION OF THE "SECOND" INVESTMENT DECISION" RULE WAS IRRELEVANT AND IMMATERIAL TO THE ISSUE OF PLAINTIFFS' DAMAGES.

The Petitioner's argument on this point suffers from the same fatal flaw as its argument in Point II of its Petition for Certiorari concerning the issue of damages, namely it is based upon an incorrect characterization of what constituted the Plaintiffs-Respondents' damages in this case. As discussed earlier in Point II of this Answer, the damages consisted of the difference between the actual value of the bonds and the price paid for them on the date of issue, not the "market drop" itself. [Op. A-18-19] The Circuit Court made it plain that it was applying the **principle** of the "second investment decision" rule as

stated in *Harris v. American Investment Co.*, 523 F.2d 220, 228 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976), although the *Harris* Court's enunciation of the rule was in response "to the argument that the investor should have mitigated his damages by selling his stock after discovering the fraud". [Op. A-27] The Circuit Court thus continued to recognize that the "market drop" did not constitute the damages in this case. If it were, the Circuit Court here would have been responding to the same mitigation argument as was the Court in *Harris*. The Plaintiffs' "second investment decision" to hold the bonds, knowing that they carried no call protection against lower interest cost refunding, was wholly unrelated to their initial decision to purchase the bonds, believing they did carry such protection, and thus was wholly unrelated to Union Electric's fraudulent conduct. Any fluctuations in market price after that time, then, are not relevant to the issue of damages in a cause of action under Rule 10b-5. This, coupled with the measure of damages used in the instant case, is why the "recovery of the bonds two months later, and the continued receipt of interest payments have no bearing on the measure of the plaintiffs' damages caused by UE's fraudulent conduct". [Op. A-27] Recovery of the bond price occurred after the "second investment decision" and the interest payments were the same after discovery of the fraud as they were before. The evidence offered by the Petitioner was therefore irrelevant and immaterial to the issue of how much more the Plaintiffs-Respondents paid for the bonds than they were actually worth as measured by that difference on the date the bonds were issued. As an aside, it certainly would have been interesting to see what the Peti-

tioner's position on this point would have been had the market price of the bonds continued to fall.

The Eighth Circuit correctly decided that the District Court did not abuse its discretion in excluding evidence of the continued interest payments and of the recovery of the market price of the bonds two months after the discovery of Union Electric's fraudulent conduct, because that evidence was irrelevant and immaterial to the issue of Plaintiffs-Respondents' damages. The Eighth Circuit's rulings on the exclusion of such evidence was in keeping with its previous rulings on the same issue in *Harris v. American Investments Co.*, 523 F.2d 220, 228 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976) and *Shapiro v. Midwest Rubber Reclaiming Co.*, 626 F.2d 63 (8th Cir. 1980), *cert. denied*, 449 U.S. 1079 (1980). This Court has twice before refused to grant certiorari to review this issue and should do so again. Petitioner's Point IV, B in its Petition for Certiorari is without merit.

CONCLUSION

For the foregoing reasons, Union Electric's Petition for a Writ of Certiorari to review the judgment and Opinion of the Eighth Circuit should be denied.

Respectfully submitted,

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